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From:

Sent: Wednesday, December 7, 2011 10:13 PM

To:

Cc:

Subject: Adoption tax credit - post-finality QAE and dollar limit

Re:

Good evening,

I'm responding to your question about section 36C (the adoption tax credit) and its dollar limitations. The taxpayers, husband and wife, adopted three children from Foreign Country in adoptions finalized in . The taxpayers spent \$ in qualified adoption expenses (QAE) in and another \$ of QAE in (the year they were able to bring the children to the U.S. from Foreign Country).

The adoption credit's dollar limitation is indexed for inflation.

The 2007 dollar limitation was \$11,390 per child (maximum, therefore, of \$34,170 for 3 children).

The 2008 dollar limitation increased by \$260 per child, to \$11,650 (maximum, therefore, of \$34,850 for 3 children -- or \$780 more total [3 x \$260]).

The taxpayers' aggregate QAE was \$ (\$ plus \$). Thus, the aggregate QAE exceeded both the maximum dollar limit for (\$) and the maximum dollar limit for (\$). You asked whether taxpayers are limited to the \$ figure (because was the year of finalization) or whether they can absorb an additional \$ of QAE via the increased dollar limitation (\$).

Answer: On these facts, the taxpayers' aggregate dollar limitation is \$ -- the sum of the \$ from plus the \$ increased dollar limitation (\$ x 3) from .

Two factors are at play here: (1) The dollar limitation increased; and (2) the taxpayers paid additional ("new") QAE in . Both factors are essential to the result.

In a foreign adoption, all QAE paid before or during the year of finality is treated as if it were paid in the year of finality. For example, a taxpayer paying \$4,000 of QAE in 2005, \$6,000 in 2006, and \$8,000 in 2007 will be treated as if she had paid all \$18,000 in 2007. The modified adjusted gross income limitation and the dollar limitation for 2007 are applied to that \$18,000 ("old" QAE). If the taxpayer had adopted one child, the maximum credit allowable would be \$11,390. The remaining \$6,610 of "old" QAE (\$18,000 less \$11,390 dollar limit) is lost forever: the taxpayer will never receive a tax benefit from that amount.

However, suppose the taxpayer paid new QAE of \$1,000 in 2008. Because the adoption finalized in 2007, the new QAE is "post-finality QAE." Post-finality QAE is allowable in the year it is paid. Because the 2008 MAGI and dollar limits are applied to the new QAE, \$260 of that new QAE is allowable. The taxpayer's aggregate credit therefore will be \$11,650 (\$11,390 plus \$260).

Again, what's crucial here is that new QAE was paid in the later year. If there'd been no new QAE paid in 2008, there would be no additional credit amount: the unusable *old* QAE of \$6,610 cannot be offset against the 2008 inflation indexed amount.

Minor additional points:

1. Suppose the taxpayer had paid only \$200 new QAE in 2008. In that case only \$200 would be allowable, not \$260. That is, \$260 is a cap on the amount of new QAE allowable, not a floor. If less is paid than the cap, the lesser amount is what's allowable.

2. Re-adoption expenses are examples of post-finality QAE. Suppose a taxpayer spent \$600 of new QAE in 2009, re-adopting the child in his state of domicile. In this circumstance \$500 of the \$600 new QAE could be used (\$12,150 dollar limit in 2009 less \$11,650 dollar limit in 2008 equals \$500).

Please contact me if I can be of further assistance.